

## Changes in store for head of household filers

Rules for using the head of household (HOH) filing status have changed for tax year 2005. Some of your clients may discover that they are no longer eligible to claim the HOH filing status.

California Assembly Bill 115 (Stats. 2005, Ch. 691) conforms California law to Public Law 108-311, the *Federal Working Families Tax Relief Act of 2004*. The act provides a "uniform definition of a child," which applies to several areas of tax law including the requirements for filing as a head of household.

The new law took effect on January 1, 2005 and makes some significant changes to the requirements for who is a "qualifying person" for HOH filing status. Qualifying persons are now separated into two distinct categories: qualifying child and qualifying relative.

In addition, a taxpayer is entitled to a dependent exemption credit for a qualifying child or qualifying relative who meets the joint return and citizenship tests set forth below to be a dependent (The taxpayer cannot claim a dependent exemption credit for anyone if the taxpayer can be claimed as a dependent by another taxpayer.):

- Did not file a joint return.
- Is a citizen or national of the U.S. or a resident of the U.S., Canada, or Mexico.

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## Include use tax on California income tax returns

Use tax is one of the most overlooked aspects of state tax law. California use tax law became effective on July 1, 1935. Section 6201 of the Revenue and Taxation Code established the use tax to eliminate the price disadvantage to California businesses when California consumers purchase taxable merchandise from out-of-state retailers. In general, taxpayers must pay California use tax on purchases made from out of state if the seller does not collect California sales or use tax, and the taxpayer uses, gives away, stores, or consumes the item in this state.

State Legislation passed in 2003 added a use tax line to California's income tax returns, making it easier for consumers to report and pay use tax on their purchases. Several other states also allow taxpayers to report use tax on their state income tax returns. In an analysis of individual returns from tax year 2003, we found that taxpayers who self-prepared their returns were nearly eight times more likely to declare use tax than those who used a tax practitioner. Nearly 63 percent of all individual returns we received were practitioner-prepared. Yet, only 16.6 percent of all use tax declarations were made on practitioner-prepared returns.

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**Tax News** is a bimonthly publication of the Communications Services Bureau of the California Franchise Tax Board. Our primary objective is to provide information to income tax practitioners about state income tax laws, regulations, policies and procedures.

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#### Tax Practitioner Services

Our Tax Practitioner Support Unit is available from 8 a.m. to 5 p.m., Monday through Friday. Our telephone number is (916) 845-7057. You can send us a fax 24 hours a day, seven days a week. Our fax number is (916) 845-6377.

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# Twelve steps to filing success

The annual filing season is here. If you find yourself wondering what kinds of things you can do to minimize errors and help your clients' tax returns sail through our processing system, we may be able to help. Situations that require special handling are often the reason for slower processing. Listed below are some steps to avoid special handling and expedite processing of your clients' returns:

1. **Use an electronic payment option.** Is it important to you to get immediate confirmation regarding payments? If it is, then we suggest that you choose one of our electronic payment options. You will receive a confirmation of the payment request, no matter which payment option you choose.

If you are e-filing, then making a return payment is fast, easy, and convenient. Just follow the electronic payment instructions in your e-file software and you will receive a confirmation number for the return and payment. If you choose to file early, you can request the payment be withdrawn on the payment due date. Also, if your client makes estimated tax payments, you can schedule the payments when you e-file and your client doesn't need to remember to mail a check. Check your software to see if it supports this option.

Additionally, we accept credit card payments, and offer a "Web Pay" service, which works much like a debit card. With Web Pay your client can pay the amount they currently owe and can schedule future payments, such as estimated tax, up to one year in advance. Your client selects the amount they want to pay and when they want to pay it.

With your client's permission and their Customer Service Number, you can use our "View Estimated Tax Payments and Balance Due" service to check estimate payments and ensure that payments are up to date and posted correctly.

You can find more information about our electronic payment options by visiting our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov).

2. **Advise your clients to send us estimate payment vouchers only when there is a payment due.** We receive many estimate payment vouchers without a check, showing a "0" payment due. This may happen if you give your clients their estimate vouchers and tell them to "send their payments on the following dates." They may not realize, however, that they do not need to send in the voucher if there

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## Include use tax on...

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Please inform your clients of the possibility that they may have a use tax liability. For many taxpayers this new line added to our income tax returns is their first introduction to the idea of a use tax. If your clients have a use tax liability, advise them to report it on their California income tax return. It's easier and more

convenient to report it to us than reporting it separately to the Board of Equalization. Our income tax booklet instructions contain general information about the use tax and a worksheet to calculate the amount due. You may obtain additional information regarding use tax from the Board of Equalization at [www.boe.ca.gov](http://www.boe.ca.gov).

# FTB mails notices to nonfilers

In December 2005, FTB mailed over 800,000 notices to people we believe should have filed a Personal Income Tax return for the 2004 tax year. Our request for a tax return is based on information we receive from sources such as banks, financial institutions, other state agencies, and the Internal Revenue Service.

Our notice informs the taxpayer that we are unable to locate a tax return under the name and social security number listed on the notice. If any of your clients receive a nonfiler notice, you will automatically receive a copy of the notice if you have a valid Power of Attorney on file with us for the 2004 tax year.

The quickest way to respond to a notice is to log on to our public Website at [www.ftb.ca.gov/INC](http://www.ftb.ca.gov/INC), which allows you to request more time, resolve problems, and obtain information and forms.

You can also get in touch with us by calling our Interactive Voice Response phone system at (866) 204-7902 or using the email feature on our public Website. For your convenience, these services are available seven days a week, 24 hours a day. If you wish to write to us, or send a fax, you will find instructions for both of these options printed on the notice.

## Changes in store for head of household filers

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A qualifying *child* is the taxpayer's birth child, stepchild, adopted child, eligible foster child, sibling, step-sibling, half-sibling, or a descendent of such a person who:

- Lives in the taxpayer's home for more than one-half of the year.
- Did not provide more than one-half of his or her own support.
- Is either under the age of 19 or is a student who is under the age of 24.

A qualifying *relative* is the taxpayer's birth child, stepchild, adopted child, eligible foster child or a descendent of such a person; or a sibling, step-sibling, half-sibling, parent, grandparent, stepparent, nephew, niece, aunt, or uncle; or an in-law (parent, child, or sibling by marriage); or a person (except the taxpayer's spouse) who lives with the taxpayer for the entire year as a member of the taxpayer's household who:

- Has gross income less than the federal exemption amount for the year in question.
- Receives more than one-half of his or her support for the year from the taxpayer.
- Is not a *qualifying* child of the taxpayer, or of anyone else.

A person who meets the requirements to be the taxpayer's qualifying relative by living with the taxpayer all year as member of his or her household, but who is not one of the relatives described above, **can** qualify the taxpayer for a dependent exemption credit, but **cannot** qualify the taxpayer for HOH filing status.

In addition to the new qualifying person categories, the law also clearly defines "eligible" foster child. To qualify the taxpayer for HOH filing status, an eligible foster child must be placed with the taxpayer by an authorized placement agency or by a court order. There is no requirement that the eligible foster child must live with the taxpayer for the entire year, as was true under pre-2005 law.

The following requirements to qualify for HOH filing status are the same as in previous years:

- The taxpayer must be unmarried or meet the requirements to be considered unmarried on the last day of the tax year.
- The taxpayer must have paid more than one-half the costs of keeping up the home.
- The home must have been the main home for the taxpayer and a qualifying person who lived with the taxpayer for more than one-half of the year.
- The taxpayer was not a nonresident alien at any time during the year.

Most taxpayers who qualified for head of household filing status under the old law will also qualify under the new, but you may find that some of your clients are disqualified by the new rules.

For example, your unmarried client's unmarried child no longer qualifies your client for head of household filing status if the child is 19 years of age or older, is not a student, and has gross income equal to or greater than the federal exemption amount (\$3,200 in 2005). Moreover, if your client's unmarried child is under 19 years of age, or is a student under age 24, but provides more than one-half of his or her own support, the child no longer qualifies your unmarried client for HOH filing status.

We urge you to review the new HOH provisions to determine your client's correct filing status. You can order a copy of FTB Pub. 1540, *California Head of Household Filing Status*, by calling (800) 555-4005 or by downloading it from our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) (enter Pub 1540 in the search field). The Pub. 1540 and the Website list the new requirements and also have self-tests that you can use to help you and your clients determine if they qualify for HOH filing status under the new rules.

# New voluntary contribution funds

In 2005, California taxpayers made more than 390,000 contributions to the state's voluntary contributions funds totaling more than \$4 million.

This year, taxpayers have three new funds to consider when making the choice to contribute:

- Veterans' Quality of Life Fund.
- California Colorectal Cancer Prevention Fund.
- California Sexual Violence Victim Services Fund.

These three new funds are listed along with the 11 other charitable funds, on Side 2 of the tax form.

With tax season already upon us, please keep these voluntary contribution funds in mind when consulting with your clients this spring. Without you to remind them, There's a good chance they will miss out on the opportunity to make a tax-deductible contribution to one or more of these worthy causes.

## Twelve steps to filing success

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is no payment due or if they paid electronically. This is also true for extension payment vouchers. We've even had taxpayers send us their "no payment due" vouchers via certified mail, paying extra to mail an item they didn't need to send in the first place.

For corporation and other business entity payment vouchers, make sure the corporation or account number is included on the voucher and check. This ensures that the payment is quickly applied to the correct account. The 2006 vouchers have a new field asking for a telephone number so we can call if we need additional information to correctly apply the payment.

3. **Use the right form, for the right year.** The scanners we use to capture information save us time and money. Our scanners can identify a form by a series of numbers usually located at the bottom of the document or voucher. Trying to use a 2004 estimate payment voucher as a 2005 voucher by crossing out the "04" and replacing it with "05" doesn't work. The scanner will reject the transaction, requiring special handling to process the voucher.
4. **Specify how multiple payments should be applied, especially when using a single check.** Without clear direction on where a payment should be applied, processing is suspended while our staff researches how to correctly allocate the payment.

5. **Provide complete and accurate account numbers for your clients.** When we receive a tax return that is missing the social security number, we have to manually search for the number and add it to the return. This can be a very time-consuming process.

If you have clients that are corporations or other business entities, it is equally important to include their corporation or account numbers on their tax returns.

6. **The "scan band" must match return data.** A scan band is printed at the top of each California return that is prepared and printed by tax software like Turbo Tax. The scan band incorporates all of the return's numeric information, which is then captured by the scanner. If you make changes to data on the return, make sure those changes are also reflected in the return's scan band so that we capture the correct information.
7. **Neatness and accuracy count in payment processing.** The clearer the handwriting, the more accurately the scanner can read the check.
8. **Make sure that returns are sent to the correct FTB address.** Every year we receive returns with checks at our non-remit address, and refund returns at our remit address. Proper addressing saves us time and money in processing the returns. To determine the correct address for the type of return you are filing, refer to

the *Franchise Tax Board - Return Mailing Addresses* page on our Website. The direct link is: [www.ftb.ca.gov/AboutFTB/add.html](http://www.ftb.ca.gov/AboutFTB/add.html)

9. **Only attach required forms or schedules.** Many people attach their federal tax returns or other schedules to their California returns even when they aren't required. FTB processes more than 15 million tax returns each year, many of them multiple-page, in addition to millions of other forms and documents. Minimizing unnecessary paper can significantly speed up processing and reduce the cost of storage and processing.
10. **Counsel your clients to avoid stapling, gluing, or taping checks to tax returns, or any other documents.** Processing slows down considerably when we have to remove checks while trying to avoid damaging the return or document the checks are attached to. Our instructions ask taxpayers to *include*, not *attach* their checks.
11. **Make sure that checks are not torn or taped.** Our scanning hardware is very fast and efficient, except when it encounters checks that are torn or taped.
12. **Encourage clients to pay by check or Web Pay instead of money orders.** Money orders require special handling because they are difficult for our scanners to read.



# Information letters sent to S corporations with California income and nonresident shareholders

FTB is stepping up filing enforcement efforts directed at nonresident shareholders of S corporations. Some time after January 1, 2007, we currently plan to begin requiring S corporations to withhold tax on distributions of California source income to nonresident shareholders; currently required for partnerships and LLCs. FTB recently mailed letters to S corporations with California source income and nonresident shareholders to inform them of their nonresident shareholders' filing requirements. The letters included filing requirement information for S corporations to distribute to their nonresident shareholders. We will send notices to S corporations before initiating the withholding requirement.

Nonresidents who receive California source income as shareholders in an S corporation must file California nonresident tax returns to report the income and pay any tax due. Nonresident S corporation shareholders may also elect to file a group nonresident return if they have California source income. For more information, refer to FTB Publication 1067,

*Guidelines for Filing a Group Form 540NR*, available on our public Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) (search for Pub 1067). To be eligible to make this election, shareholders must have no California source income other than from this S corporation.

A waiver process is available for nonresident shareholders who are currently filing California nonresident income tax returns, either individually or as part of group nonresident return. Use Form 588, *Nonresident Withholding Waiver Request* to request a waiver of the withholding requirement (search for Form 588 on the FTB Website).

For questions about nonresident withholding requirements, call FTB's Withholding Services and Compliance Section toll-free at (888) 792-4900. Filing information, as well as the forms and publications referred to above are available at FTB's Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) or by calling FTB's Tax Practitioner Hotline at (916) 845-7057, or FTB's Taxpayer Services Center at (800) 852-5711 or (916) 845-6500.

## California tax shelter resolution initiative

The FTB issued Legal Notice 2006-1 on January 11, 2006, announcing that it will closely follow the IRS tax shelter settlement initiative as outlined in IRS Announcement 2005-80, effectively creating the California Tax Shelter Resolution Initiative to run alongside the federal initiative. Notice 2006-1 is included in this issue of Tax News as an insert.

Only those taxpayers who are qualified to participate in the IRS Initiative and who fully complete the requirements of the program are eligible for the California program. Participants can avoid most California tax shelter penalties, including the non-economic substance transaction understatement penalty.

To participate in the California Initiative, taxpayers will be required to sign a closing agreement with FTB relinquishing all appeal and refund rights. Participants are required to pay 100 percent of the taxes owed, interest, and the applicable accuracy related penalty, which ranges from 5-20 percent. Participants are allowed to deduct their out-of-pocket promoter fees and transaction costs as an ordinary loss. The California Initiative runs through March 31, 2006. Taxpayers wanting to participate must file FTB Form 638, *California Tax Shelter Resolution Initiative Election to Participate in Notice 2006-1*. Taxpayers who do not participate are subject to California's stiff abusive tax shelter penalties.

### DON'T FORGET...

*Tax News* will be going totally online beginning with the May issue. If you are currently a subscriber, you don't need to re-subscribe. And, if you have paid in advance beyond May for the print version of *Tax News*, we will issue you a prorated refund.

# FTB taking a closer look at tax preparers

Unscrupulous tax preparers are the focus of FTB attention on several enforcement fronts.

- In a joint program with the California Tax Education Council (CTEC), FTB staff will visit tax preparers regulated under the *California Business and Professions Code* Sections 22250-22259. Under these code sections, tax preparers charging a fee for their services must be registered with CTEC. Those found to be in violation of the code would be immediately subject to the Tax Preparer Penalty (Revenue and Taxation Code Section 19167). The initial penalty for those who fail to register is \$2,500. However, if preparers comply with the provisions

of the law within 90 days, the penalty will be withdrawn. For subsequent violations, the penalty increases to \$5,000.

- We use modeling techniques to identify tax return trends and patterns in credits, and overstatement of deductions on Schedules A and C. Our auditors then examine tax returns and assess additional tax for understated tax liabilities or underreported income. We may also assess penalties on preparers involved in preparing returns that claim erroneous credits or deductions.
- California law requires tax preparers who annually prepare more than 100 California personal income tax returns

to e-file these returns. FTB will be contacting those preparers who appear to meet the requirements for mandatory e-file but who instead file a large portion of their returns by paper. For more information on mandatory e-file or joining the California e-file program, go to [www.ftb.ca.gov](http://www.ftb.ca.gov) and search for Mandatory e-file.

- This year FTB has significantly increased staff to verify the refundable *Child and Dependent Care Expenses Credit*, to prevent and recover fraudulent claims. To verify claimed credits, we are sending letters to care providers to confirm information reported on returns.

## Early debut for FTB's redesigned Website

Many of you have probably already noticed the changes to the *Tax News Online* web page, and to the FTB Website in general. The new and improved FTB Website was unveiled November 30, beating the original launch date of January 6, 2006 by more than a month. The FTB Website redesign team based the new design on usability research and customer input. We think you will find it more intuitive and easier to navigate. One of the outcomes of our discussions with tax practitioners was the *Tax Professionals Corner*, which is part of the new Website design. We know you need to find information as quickly and efficiently as possible – especially during filing season. We believe that our new design will make information searches a whole lot easier.

To help you become familiar with it, we will periodically feature different areas of the new Website in *Tax News*. Here are answers to a few questions we've received since launching the redesigned Website:

### How do I find *Tax News* online?

The new FTB homepage has tabs across the top for information and services used

by individual and corporate taxpayers, tax professionals, and people looking for general information. To find *Tax News*, click on the *News* tab. On the *News* page, click on *Tax News* listed in the middle of the page. Or, you can enter *Tax News* in the search field to arrive at our homepage.

### What is the *Tax Professional's Corner*?

On the FTB Website homepage, you will find three sections labeled *Quick Links*, *Tools*, and *Tax Professionals*. The *Tax Professional's Corner* gives you quick links to information and services targeted to your needs, based on feedback we received from a cross section of tax practitioners and tax software developers.

### Where do I find news items that are important for me to know about quickly?

Check *Announcements*, located in the lower third of the homepage. It provides links to important, recently released news items. *Announcements* will be updated regularly to stay current with what's most important at any given time.

### Why did you change the Website's format?

The Internet is still very much a growing and evolving communications medium. Internet users have steadily gained experience and become more adept at navigating and searching for information. You will find this reflected in many Internet Websites. We know that the users of our Website have become increasingly Web-experienced and we strive to meet your needs as they evolve. To that end, we work with an expert usability consultant to study the latest research in Web trends, and we test the usability of all aspects of our Website. We ask our customers – taxpayers, tax professionals and tax software developers – what they need and want from their FTB Website experience. Our goal is to streamline the site, remove redundant pages and content, and reorganize the site to make navigation more intuitive. We've also added some new features, including a glossary and restructured FAQs (look under *Quick Links* on the homepage). The result is our new Website. We hope you like it.

# Criminal corner

## Family Business

This issue of *Criminal Corner* describes two cases involving criminal behavior as a family enterprise. Both cases are good examples of income underreporting: a key contributor to California's \$6.5 billion tax gap and defined as the difference between the tax that is due and the tax that is paid.

FTB special agents arrested Alfredo R. Gutierrez, 51, of Indio, and Otto H. Ludwig, 32, of La Quinta, on felony charges of filing false state income tax returns and negotiating fraudulently obtained state income tax refund checks.

Gutierrez is the owner and operator of GC Services, aka Gutierrez Consulting Services, a tax preparation service. Ludwig is Gutierrez' nephew, and works as a tax preparer. According to FTB special agents, Gutierrez and Ludwig allegedly filed more than 200 returns for clients claiming false or inflated child and dependent care credits between 2000 and 2002, generating false state income tax refunds of \$93,680. The duo benefited by the larger customer base the scheme generated for the business.

In one case, a return prepared by Gutierrez showed the taxpayer filed as head of household and claimed the child and dependent care credit. During an interview with FTB special agents, the taxpayer stated he was married and his wife took care of their children. The taxpayers' copies of the returns do not list the fraudulent claims.

The scheme was discovered by FTB's internal fraud detection process. The investigation involved numerous interviews with the affected taxpayers. Each tax count carries a maximum term of three years in state prison.

A Pinole woman reached a plea agreement with the Franchise Tax Board, pleading guilty to two felony charges of elder abuse and three felony charges of filing false state income tax returns, in exchange for misdemeanor charges against her children.

Carmen Paredes, 59, was employed as the caretaker of an elderly Contra Costa man. According to court documents, Paredes abused her position of trust by embezzling more than \$600,000 from her employer between 1998-2000. It was discovered during the investigation that Paredes' adult children, Gustavo Paredes, 31, Claudia Paredes, 28, and Alfonso M. Paredes, 31, were also involved in the scheme. The elder Paredes failed to claim any of this income on her 1998-2000 state income tax returns. All income is taxable including income from illegal sources. Paredes owes the state more than \$69,000 in additional state income tax, penalties, and interest. Restitution to the victim and the FTB will be determined later. She was sentenced to time served.

Claudia Paredes and Alfonso M. Paredes each pleaded guilty to one misdemeanor count of aggravated trespass. They each received 15 days in county jail, plus 100 hours of community service, and were placed on three years probation. In addition, each was ordered to file corrected state tax returns, and pay all the tax, penalties and the cost of the investigation.

## Corrections to 2006 Franchise Tax Board Information Directory

After the November/December issue of Tax News went to press, we discovered an incorrect phone number and an incorrect address listed in form FTB 1240, *2006 Franchise Tax Board Information Directory*, which was included with your November/December issue.

### e-file Phone number

The number listed on page 2, located under the "E" heading, is incorrect. It should read **(916) 845-0353**. The correct e-file number is printed on the front page of the Directory, under the heading "Tax Practitioner Services". Please refer to the phone number on page 1 when you need to contact us about e-file issues.

### Withholding Services and Compliance Section mailing address

The mailing address on page 4 is incorrect. The correct address is:

Withholding Services and Compliance Section  
Franchise Tax Board  
PO Box 942867  
Sacramento CA 94267-0651

The updated Directory is on our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) (search for FTB 1240). We regret any inconvenience that this may cause.

# e-file News



## Thank you from the e-file Program

Last year, almost 7 million returns were e-filed by tax practitioners. If you are one of the more than 35,000 practitioners who e-filed last year, we say THANK YOU!

If you're not enrolled in our e-file Program, it takes only a few minutes to register on our Website. Follow these simple steps:

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### Step 1: Enroll in the Internal Revenue Service e-file Program.

You need an IRS Electronic Filing Identification Number to enroll in our e-file Program. To obtain an identification number, visit the IRS Website at [www.irs.gov](http://www.irs.gov), and search for EFIN.

### Step 2: Enroll in our e-file Program.

Go to our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) and search for Join e-file. Complete and submit our new online *California e-file Program Participant Enrollment* form (FTB 8633).

If you prefer to fax or mail your enrollment form, you can download the paper version from our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov). Use the fax number or address shown on the enrollment form.

### Step 3: We process your enrollment form.

After we receive your enrollment form, we will review your account to ensure that all your business entities are valid and licensed, all personal and business tax returns are filed timely, and all liabilities are current.

### Step 4: We send you an acceptance letter.

When you have successfully enrolled, we will issue you an acceptance letter.

### Step 5: e-file enrollment is complete.

When you receive your acceptance, you can begin e-filing returns.

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## California e-file CD discontinued

We've discontinued our California e-file CD. However, the information that was on the CD is available on our Website. You can download our *2005 e-file Handbook* (FTB Pub. 1345), *2005 Individual e-file Handbook Supplement* (FTB Pub. 1345A), *2005 Business e-file Handbook* (FTB Pub. 1345B), e-file quick references, and other resource information.

We've categorized the e-file publications on our Website by the table of contents sections where they are listed, as well as by form number. This gives you the ability to download only the information you're interested in. Go to [www.ftb.ca.gov](http://www.ftb.ca.gov) and search for e-file Forms.

## Use e-file for your clients' corporate tax returns in 2006

New this year is our California Business e-file Program that premiered in January 2006. Business e-file complements our existing e-file program for individual taxpayers. Participants in the California Business e-file Program will need to:

- Be accepted in the IRS e-file program.
- Enroll in the California program.

If you are already enrolled in the California e-file program, you **do not** need to enroll again for Business e-file. If your office would like to use different contact information for Business e-file, please update your information using our online enrollment form at [www.ftb.ca.gov](http://www.ftb.ca.gov) (search for Join e-file).

All the information you will need for Business e-file, including the list of approved software providers, is available on our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) (search for e-file). For California Business e-file questions, please contact us at:

### e-Programs customer service

Phone: (916) 845-0353

Email: [e-file@ftb.ca.gov](mailto:e-file@ftb.ca.gov)

### e-file subscription service

FTB's new e-file Subscription Service allows you to receive email messages about e-file information, issues, events, and services important to you! To subscribe or get more information go to [www.ftb.ca.gov](http://www.ftb.ca.gov) and search for Subscription Service.



# Assembling scannable tax returns with the new schedule W-2 CG

Please note the text below in **bold type** for additional information on assembling scannable returns with Schedule W-2 CG.

Tax practitioners who prepare scannable returns can use computer-generated CA Schedule W-2 CG to report certain W-2 information for taxable years beginning on or after January 1, 2005.

The Schedule W-2 CG works with our scannable form 540 and computer prepared Forms 540 2EZ, 540NR short or long, and 540X. The computer program will generate a Schedule W-2 CG. (If you prepare returns manually, you will continue to use the regular Schedule W-2.)

Follow these steps when assembling your clients' scannable Forms 540 to help us work more efficiently and speed up tax return processing:

1. If your clients have Forms W-2, the software should populate the forms with your California W-2 information. You must attach to Form W-2 CG all forms that show California tax withheld, except Form W-2.
2. If it does not, use our new Schedule W-2 CG, *California Wage and Withholding*, to help us keep track of them. To use it, attach paper copies of the Form W-2, W-2G, 1099 showing California tax withheld, 592-B, 594, and 597 to the Schedule W-2 CG instead of attaching them to the face of the tax return.
3. Leave the first page of the return loose. Do not attach anything to it.
4. Place any payments inside your envelope. Do not attach payments to the return.
5. Staple the rest of the return together: page 2, followed by Schedule W-2 CG, followed by all other schedules and attachments in the usual order.

TAXABLE YEAR	SCHEDULE
2005	W-2
<b>Wage and Withholding Summary</b>	
Important: Attach this schedule directly behind Side 2 of your return.	
Name(s) as shown on return	SSN or ITIN

Attach your Form(s) W-2 to the front of your income tax return, or complete CA Sch W-2. Use this schedule to transfer information from your Form(s) W-2. If you need more space, complete a separate CA Sch W-2. If you complete a CA Sch W-2, do not submit your Form(s) W-2. Keep them for your records. The amounts from your Form(s) W-2 should be transferred to the appropriate boxes on this schedule. If Form(s) W-2 contain data from multiple states, you cannot use this form. The shaded areas need to be completed to ensure excess SDI claims.

**Taxpayer W-2 information.** (Transfer amounts from your Form(s) W-2 to the appropriate boxes below.) Complete a box for each Form W-2 you receive.

1st W-2	2nd W-2
Social Security Number (box d)	Social Security Number (box d)
Employer ID Number (EIN) (box b)	Employer ID Number (EIN) (box b)
State & Employer's State ID Number (box 15)	State & Employer's State ID Number (box 15)
Employer Name (box c)	Employer Name (box c)
State Wages, Tips, etc. (box 16)	State Wages, Tips, etc. (box 16)
CA State Income Tax (box 17)	CA State Income Tax (box 17)
Social Security Wages (box 3)	Social Security Wages (box 3)
SDI (Local Income Tax) (box 14 or 19)	SDI (Local Income Tax) (box 14 or 19)

  

3rd W-2	4th W-2
Social Security Number (box d)	Social Security Number (box d)
Employer ID Number (EIN) (box b)	Employer ID Number (EIN) (box b)
State & Employer's State ID Number (box 15)	State & Employer's State ID Number (box 15)
Employer Name (box c)	Employer Name (box c)
State Wages, Tips, etc. (box 16)	State Wages, Tips, etc. (box 16)
CA State Income Tax (box 17)	CA State Income Tax (box 17)
Social Security Wages (box 3)	Social Security Wages (box 3)
SDI (Local Income Tax) (box 14 or 19)	SDI (Local Income Tax) (box 14 or 19)

**Spouse W-2 information.** (Transfer amounts from your Form(s) W-2 to the appropriate boxes below.) Complete a box for each Form W-2 you receive.

1st W-2	2nd W-2
Social Security Number (box d)	Social Security Number (box d)
Employer ID Number (EIN) (box b)	Employer ID Number (EIN) (box b)
State & Employer's State ID Number (box 15)	State & Employer's State ID Number (box 15)
Employer Name (box c)	Employer Name (box c)
State Wages, Tips, etc. (box 16)	State Wages, Tips, etc. (box 16)
CA State Income Tax (box 17)	CA State Income Tax (box 17)
Social Security Wages (box 3)	Social Security Wages (box 3)
SDI (Local Income Tax) (box 14 or 19)	SDI (Local Income Tax) (box 14 or 19)

  

3rd W-2	4th W-2
Social Security Number (box d)	Social Security Number (box d)
Employer ID Number (EIN) (box b)	Employer ID Number (EIN) (box b)
State & Employer's State ID Number (box 15)	State & Employer's State ID Number (box 15)
Employer Name (box c)	Employer Name (box c)
State Wages, Tips, etc. (box 16)	State Wages, Tips, etc. (box 16)
CA State Income Tax (box 17)	CA State Income Tax (box 17)
Social Security Wages (box 3)	Social Security Wages (box 3)
SDI (Local Income Tax) (box 14 or 19)	SDI (Local Income Tax) (box 14 or 19)

- A. Total state wages from your Form(s) W-2 for taxpayer (Add box 16 from all Form(s) W-2 for taxpayer) ..... \$
- B. Total state wages from your Form(s) W-2 for spouse (Add box 16 from all Form(s) W-2 for spouse) ..... \$
- C. Total California Wages from all Form(s) W-2 (Add line A and line B, and enter on line C) ..... \$
- D. Transfer the amount on line C to Form 540 2EZ, line 9; Form 540A, line 12a; Form 540, Form 540NR (Short or Long), line 12; or Form 540X, line 1a, Column B.

TAXABLE YEAR	SCHEDULE
2005	W-2 CG
<b>Wage and Withholding Summary</b>	
Important: Attach this schedule directly behind Side 2 of your return.	
Name(s) as shown on return	SSN or ITIN

**Caution:** If your Form(s) W-2 are from multiple states, or this schedule is not filled out, only use this schedule to attach copies of your Form(s) W-2, 592-B, 593-B, 594, and 1099 showing CA tax withheld to it. Attach this schedule directly behind Side 2 of your return.

**Taxpayer W-2 information.** (Transfer amounts from your Form(s) W-2 to the appropriate boxes below.) Complete a box for each Form W-2 you receive.

1st W-2	2nd W-2
Social Security Number (box d)	Social Security Number (box d)
Employer ID Number (EIN) (box b)	Employer ID Number (EIN) (box b)
State & Employer's State ID Number (box 15)	State & Employer's State ID Number (box 15)
Employer Name (box c)	Employer Name (box c)
State Wages, Tips, etc. (box 16)	State Wages, Tips, etc. (box 16)
CA State Income Tax (box 17)	CA State Income Tax (box 17)
Social Security Wages (box 3)	Social Security Wages (box 3)
SDI (Local Income Tax) (box 14 or 19)	SDI (Local Income Tax) (box 14 or 19)

  

3rd W-2	4th W-2
Social Security Number (box d)	Social Security Number (box d)
Employer ID Number (EIN) (box b)	Employer ID Number (EIN) (box b)
State & Employer's State ID Number (box 15)	State & Employer's State ID Number (box 15)
Employer Name (box c)	Employer Name (box c)
State Wages, Tips, etc. (box 16)	State Wages, Tips, etc. (box 16)
CA State Income Tax (box 17)	CA State Income Tax (box 17)
Social Security Wages (box 3)	Social Security Wages (box 3)
SDI (Local Income Tax) (box 14 or 19)	SDI (Local Income Tax) (box 14 or 19)

**Spouse W-2 information.** (Transfer amounts from your Form(s) W-2 to the appropriate boxes below.) Complete a box for each Form W-2 you receive.

1st W-2	2nd W-2
Social Security Number (box d)	Social Security Number (box d)
Employer ID Number (EIN) (box b)	Employer ID Number (EIN) (box b)
State & Employer's State ID Number (box 15)	State & Employer's State ID Number (box 15)
Employer Name (box c)	Employer Name (box c)
State Wages, Tips, etc. (box 16)	State Wages, Tips, etc. (box 16)
CA State Income Tax (box 17)	CA State Income Tax (box 17)
Social Security Wages (box 3)	Social Security Wages (box 3)
SDI (Local Income Tax) (box 14 or 19)	SDI (Local Income Tax) (box 14 or 19)

  

3rd W-2	4th W-2
Social Security Number (box d)	Social Security Number (box d)
Employer ID Number (EIN) (box b)	Employer ID Number (EIN) (box b)
State & Employer's State ID Number (box 15)	State & Employer's State ID Number (box 15)
Employer Name (box c)	Employer Name (box c)
State Wages, Tips, etc. (box 16)	State Wages, Tips, etc. (box 16)
CA State Income Tax (box 17)	CA State Income Tax (box 17)
Social Security Wages (box 3)	Social Security Wages (box 3)
SDI (Local Income Tax) (box 14 or 19)	SDI (Local Income Tax) (box 14 or 19)

- A. Total state wages from your Form(s) W-2 for taxpayer (Add box 16 from all Form(s) W-2 for taxpayer) ..... \$
- B. Total state wages from your Form(s) W-2 for spouse (Add box 16 from all Form(s) W-2 for spouse) ..... \$
- C. Total California Wages from all Form(s) W-2 (Add line A and line B, and enter on line C) ..... \$
- D. Transfer the amount on line C to Form 540 2EZ, line 9; Form 540, Form 540NR (Short or Long), line 12; or Form 540X, line 1a, Column B.

# FAQs: tax shelter reporting requirements and conformity to federal law

The passage of Assembly Bill (AB) 115 has prompted tax professionals to ask the Franchise Tax Board (FTB) questions about tax shelter reporting requirements. Below are two of the frequently asked questions, and detailed answers to those questions.

## Question

Do material advisors file Internal Revenue Service (IRS) Form 8264 with FTB to meet requirements under California Revenue and Taxation Code Section 18628 (as amended by AB 115)?

## Background

The American Jobs Creation Act of 2004 (P.L. 108-357) amended Internal Revenue Code Section 6111 to require material advisors to file a reportable transactions information return, which replaces IRS Form 8264, *Application for Registration of a Tax Shelter*. However, until the IRS issues further guidelines or a new form, material advisors must disclose reportable transactions, including listed transactions, by filing an information return on Form 8264. IRS Notice 2005-22, *Temporary Rules Under Sections 6111 and 6112*, clarifies and modifies Notice 2004-80 and Notice 2005-17, and states that material advisors must file an information return on Form 8264 to disclose reportable transactions, including listed transactions. This information return must be filed by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor.

AB 115 (Stat. 2005, Ch. 691) amended California Revenue & Taxation Code Section 18628 to conform to Internal Revenue Code Section 6111, as amended by the American Jobs Creation Act of 2004 (P.L. 108-357).

## Answer

Material advisors must file a reportable transactions information return with the Franchise Tax Board (FTB) when the advisor is:

- Organized in California.
- Does business in California.
- Derives income from California sources.
- Provides to a taxpayer who meets the same above criteria any material aid, assistance or advice with respect to organizing, managing, promoting, selling, implementing, insuring or carrying out any reportable transaction, including a listed transaction.

Follow these steps to determine if material advisors must file IRS Form 8264 with the FTB:

- If you or your client filed IRS Form 8264s between January 1, 2005 and October 31, 2005 with the IRS, and became a material advisor between these dates:
  - Send FTB a copy of IRS Form 8264 on or before December 31, 2005.
  - For California only listed transactions where there is a California filing requirement but no federal filing requirement, the material advisor should complete Form 8264 and send it to FTB on or before December 31, 2005.
- Material advisors with reportable transactions, including listed transactions, who meet information return filing requirements during the 4th quarter of 2005:
  - Send FTB a copy of IRS Form 8264 by January 31, 2006.
  - Send FTB a Form 8264 for California-only transactions if there is no federal filing requirement, by January 31, 2006.
- For filings after January 1, 2006, provide either a copy of IRS Form 8264, or a completed Form 8264 on a California-only basis, for the same federal periods for non-listed reportable transactions. For listed transactions, the Form 8264 is due by the later of sixty days after entering into the transaction or sixty days after the transaction becomes listed.

If an organizer filed IRS Form 8264 with the Franchise Tax Board during 2005 under CR&TC Section 18628 before the amendment made by AB 115, the material advisor is not required to file an amended or duplicate Form 8264 for the same transaction. However, the material advisor must supplement information provided on a previously filed Form 8264 if the information is no longer accurate or if there is additional information that was not available at the time the information was originally disclosed on Form 8264.

California will be issuing an FTB Notice to provide additional guidance in the near future.

CONTINUED ON PAGE 11

# FAQs: tax shelter reporting requirements and conformity to federal law

CONTINUED FROM PAGE 10

## How to report

Complete IRS Form 8264, Application for Registration of a Tax Shelter, and mail to:

Tax Shelter Filing  
Franchise Tax Board  
PO Box 1673  
Sacramento CA 95812-1673

## Private Carrier Services

Tax Shelter Filing  
Franchise Tax Board  
Sacramento CA 95827

## Question

If the IRS accepts a request for a letter ruling on a reportable transaction, and suspends the due date for disclosing the transaction, will FTB also suspend the due date?

## Background

IRS Notice 2005-22, *Temporary Rules Under Sections 6111 and 6112*, covers the due date by which a potential material advisor must disclose a transaction to the IRS. If a material advisor

submits a request for a letter ruling on or before the due date for IRS form 8264 (Application for Registration of a Tax Shelter), and fully discloses all relevant facts about the transaction, the IRS will suspend the material advisor's obligation to disclose the transaction by the due date (see Treasury Regulation Section 1.6011-4(f)).

## Answer

If the material advisor sends FTB a copy of the request for a letter ruling filed with the IRS, we will suspend the due date for disclosing the transaction. A material advisor cannot, however, ask for a similar and/or separate ruling from FTB.

## Mail a copy of the request to:

Tax Shelter Filing  
Franchise Tax Board  
PO Box 1673  
Sacramento CA 95812-1673

## Private Carrier Services

Tax Shelter Filing  
Franchise Tax Board  
Sacramento CA 95827

# FTB extends Personal Income Tax (PIT) installment agreement pilot program

FTB tested a four-month pilot program for PIT installment agreements from September 1, 2005 through December 31, 2005. We have decided to extend the program through December 31, 2006. The program modifies the prior installment agreement conditions from a maximum of \$10,000 to be paid within 36 months, to a maximum of \$25,000 to be paid within 60 months. Applicants qualify if they:

- Owe a balance of \$25,000 or less.
- Agree to pay in full within 60 months or less.
- Have filed all required personal income tax returns.

No financial statement will be required to establish an installment agreement. FTB reserves the right to file a lien as a condition of the installment agreement depending on compliance history. For further information, please contact the PIT Collection Response and Resolution Section at (800) 689-4776.

# New executive officer sworn in at Franchise Tax Board

Selvi Stanislaus was sworn in on January 17, 2006 as the Franchise Tax Board's (FTB) new executive officer. Only the fourth executive officer of the FTB since 1950, she will oversee the second largest tax department in the nation, with more than 6,000 employees in California and its three out-of-state offices.

Ms. Stanislaus is a native of Sri Lanka who immigrated to California in 1986. After earning her law degree at Lincoln Law School and a Master of laws from McGeorge School of Law, she worked in the private sector. She joined the Board of Equalization's legal staff in 1996, and has been the Acting Assistant Chief Counsel of the Tax and Fee Programs Division since April 2005.

"Taxes are in my genes," Stanislaus said. "I am very excited by this opportunity, and I look forward to making many new friends both inside and outside of the department, and continue my career serving the taxpayers of California." The daughter of an accountant, she added that her father's profession inspired her pursuit of a career in tax law.

Stanislaus replaces Gerald H. Goldberg, who retired August 31, 2005 after 25 years as the executive officer.

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